

WATER/ICRJ/RHG

Decision 04-08-038 August 19, 2004

**BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF
CALIFORNIA**

In the Matter of the Application of DEL ORO
WATER COMPANY, INC. U-61-W for authority
to borrow approximately \$100,000 (and to issue
evidence of indebtedness in connection herewith)
in order to make certain capital improvements
and engineering studies and for authority to
recover all such costs by increases in the
respective water rates of customers in its Country
Estates District in Bakersfield, California.

Application 04-05-015
(Filed May 6, 2004)

OPINION GRANTING AUTHORITY TO ISSUE DEBT SECURITIES

Summary

This decision grants in part and denies in part the authority requested by Del Oro Water Company, Inc. (DOWC) in Application (A.) 04-05-015 (Application).

DOWC requests authority, pursuant to §§ 454, 816 through 819 inclusive, 829 and 1001 of the California Public Utilities (Pub. Util.) Code and Rules 2 through 2.6 inclusive, 4, 15, 16 and 17.1(h)(1)(A)1.1 of the Commission's Rules of Practice and Procedure to borrow up to \$100,000 for improvements in its Country Estates District (DOWCCE) water system facilities and to recover the loan amount through a rate base offset.

Notice of the filing appeared on the Commission's Daily Calendar of May 12, 2004. No protests have been received.

Partial Denial of Application

On September 24, 2003, DOWC filed a draft advice letter for a general rate case (GRC) for its Country Estates District. Between May 13, 2004 and June 30, 2004, DOWC requested the Water Division to include the proposed \$100,000 plant addition (subject of the financing request in A.04-05-015) in determining ratebase.

Because the recovery of the costs associated with the financing will be addressed in the pending GRC, DOWC's request to contemporaneously secure authorization to recover costs through a rate base offset in this Application is denied without prejudice.

Background

DOWC is a Class B water utility subject to the jurisdiction of this Commission. DOWC provides water to the unincorporated area of Magalia (Paradise Pines District and Magalia District); a portion of the southern boundary of the Town of Paradise and the entire former Lime Saddle Community Service District (Lime Saddle District); the City of Ferndale (Ferndale District); the unincorporated area of Johnson Park (Johnson Park District); and a subdivision within the City of Bakersfield (Country Estates District or DOWCCE).

DOWCCE serves approximately 350 customers from two ground-water wells and presently utilizes chlorine disinfection for treatment.

Discussion

In 2003, the California Department of Health Services (DHS) received a few customer complaints from DOWCCE about low pressure and the high mineral content of the water produced by Well 03.

On December 31, 2003, DHS informed DOWC that because the water produced by Well 03 has high total dissolved solids (TDS), it does not support expansion or adding new connections in DOWCCE unless the utility demonstrates that steps are being taken to provide water of improved mineral quality.

On March 15, 2004, DOWC presented to DHS an evaluation of DOWCCE's water systems as conducted by Luhdorff and Scalmanini, the consulting firm engaged by DOWC. The recommendations presented in the report addressing the drinking water standards, system protection, and redundancy (alternative activity) are summarized below:

1. Short Term System Improvement

- a) Install a second booster pump and piping at Well 03. Both boosters would be piped in parallel and be electrically wired to alternate duty. This will provide the necessary redundancy in the event of booster pump failure and prevent depressurization of the system should one booster fail. Estimated cost is \$30,000.
- b) Install an emergency generator to provide power at Well 03 in the event of loss of power. Provide a 175 kW diesel powered generator and automatic transfer switch. This will permit both the well pump and the booster system to maintain system pressure during power outage events. Estimated cost is \$45,000.

2. Long Range Planning

- a) Development of a Water Master Plan that would address long-term water system improvements and the estimated cost for those improvements. Inclusive in the document would be: a review and analysis of future growth potential; water usage trends; fire suppression requirements; alternatives for system water supply to include water well construction, an inter-tie with an adjacent agency, or the construction of a treatment system; system computer modeling to investigate system problems and develop pipeline replacement sizing criteria; develop a program to phase out aging wells; a pump replacement/repair program for replacement of and/or improvement of the operating efficiency of aging pumping equipment; and the installation of a state-of-the-art Supervisory Control and Data Acquisition system (SCADA) to provide for monitoring of system operation, equipment failure alarms and improving overall system operational efficiency. Estimated cost is \$30,000 to \$40,000.

On March 23, 2004, DHS cited DOWC with Compliance Order No. 03-19-040-001, Violation of Upper Secondary Maximum Contaminant Level for Total Dissolved Solids. Based on a review of available chemical data, DHS concluded that the water produced by DOWCCE's Well 01 and Well 03 exceed the Recommended and Upper Secondary Maximum Contaminant Levels (MCLs) for TDS. The major violations are as follows:

1. DOWC is operating a well that produces water that does not comply with the secondary drinking water standard for TDS.
2. DOWC has failed to insure that the system is provided with a reliable and adequate source of pure, wholesome, healthful and potable water.

3. DOWC does not at all times deliver water to its customers which contains less than 1,000 mg/L Upper Level secondary drinking water standard for TDS, thereby failing to provide water to the public that complies with all primary and secondary drinking water standards.

DHS ordered DOWC to do the following:

1. Cease and desist from failing to comply with the California Health and Safety Code (H&S Code) Section 116555(a) and (c) and Title 22 of the California Code of Regulations (CCR) Section 64449 (b) by ensuring that the system is provided with a reliable and adequate source of pure, wholesome, healthful, and potable water, which is in compliance with all primary and secondary drinking water standards.
2. By June 30, 2004, submit a plan and time schedule to address water quality issues.
3. By August 1, 2004, install a second booster pump at Well 03 to improve reliability and service of the water system.
4. DOWCCE shall not extend service to the proposed 15 new homes until DHS provides a written approval to do so. DHS' approval will depend on the progress made by DOWC to address system reliability and water quality issue. DOWCCE will be required to propose a project to correct the water quality problem and eliminate the need to deliver water to the customers that does not meet the secondary drinking water standard for TDS. Viable options to resolve this problem may include:
 - a) Drilling an additional well that produces water in compliance with all drinking standards, or
 - b) Obtaining a connection to the East Niles Community Services District (CSD) to allow the purchase of domestic water. DOWC may continue to exist as the retail supplier of the purchased water, or annexation of the service area to the East Niles CSD and

dissolution of the existing Country Estates District may be considered.

- c) Provide treatment to comply with secondary MCL for TDS.

DHS also stated in the order that non-compliance with the above mentioned obligations will subject DOWC to additional judicial action, including civil penalties.

DOWC now seeks authorization to borrow up to \$100,000. DOWC has not, at the present time, entered into any contract for the loan commitment. DOWC intends to secure the loan with interest rates based on market conditions existing at the time of negotiating the terms.¹

We place DOWC on notice that the reasonableness of any resulting interest rate and cost of money arising from debt capital are normally subject to review in cost of capital or general rate case proceedings.

Use of Proceeds

The proceeds from the loan will be used to install a backup booster pump, an emergency generator and to complete a Water Master Plan as discussed earlier, and outlined in Exhibit D to the Application, and as permitted by Pub. Util. Code § 817(h), to reimburse DOWC's treasury for any amounts advanced by it for capital costs expended for DOWCCE. DOWC intends to put the capital costs financed by the loan in rate base.

The fee for this financing authority as set forth by Pub. Util. Code § 1904(b) is \$200.²

¹ In Exhibit F, Schedule 2, Country Estates District Cash Requirements Forecast, DOWC projected an issuance of a \$100,000 debt at 6.5% interest rate, payable in 20 years.

² The amount subject to the fee is \$100,000. The fee is determined as follows: $(\$2 \times (100,000/1,000)) = \200 .

Financial Information

For the period ending December 31, 2003, DOWCCE reported total operating revenues of \$72,277 and net loss of \$4,397, as shown in its 2003 Annual Report to the Commission. DOWCCE's Balance Sheet at December 31, 2003, is summarized as follows:

<u>Assets</u>	<u>Amount</u>
Net Utility Plant	\$ 73,873
Current Assets	9,537
Deferred Charges	<u>4,740</u>
Total Assets	<u>\$ 88,150</u>
<u>Capitalization and Liabilities</u>	
Common Stockholders' Equity	\$ 65,710
Retained Earnings	<u>(85,749)</u>
Total Equity	(\$ 20,039)
Long Term Debt	\$ 41,229
Current Liabilities	<u>66,960</u>
Total Liabilities	\$108,189
Total Capitalization and Liabilities	<u>\$ 88,150</u>

Projected Cash Requirements

DOWCCE's estimate of cash requirements for five years is summarized as follows:

<u>Components</u>	<u>Year 1</u>	<u>Year 2</u>	<u>Year 3</u>	<u>Year 4</u>	<u>Year 5</u>	<u>Total</u>
Construction Budget	100,000	0	0	0	0	100,000
Bonds/Notes Retired	9,000	9,000	9,000	9,000	9,000	45,000
Short-Term Debt Repaid	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>
Total Cash Requirements	109,000	9,000	9,000	9,000	9,000	145,000
Less: Cash Received from Internal Sources	<u>8,500</u>	<u>8,500</u>	<u>8,500</u>	<u>8,500</u>	<u>8,500</u>	<u>42,500</u>
External Financing	100,500	500	500	500	500	102,500
% of Available Cash to Needed Funds	8%	94%	94%	94%	94%	29%

DOWCCE's projected cash requirements indicates that internally generated funds will provide approximately \$42,500 or 29% of its total cash requirements of \$145,000 for the projected 5 years. The requested \$100,000 loan is necessary to help DOWCCE meet the majority of its \$102,500 external funds requirements.

Capital Ratios

DOWCCE's capital ratios as of December 31, 2003, are presented below as recorded and adjusted to give pro forma effect to the projected \$100,000 loan requested in the Application:

	<u>Recorded</u>		<u>Adjustments</u>	<u>Proforma</u>	
Common Stock Equity	(20,039)	(94.6)%	-	(20,039)	(16.5)%
Preferred Stock	<u>0</u>	<u>0.0%</u>	<u>-</u>	<u>0</u>	<u>0.0%</u>
Total Equity	(20,039)	(94.6)%	-	(20,039)	(16.5)%
Long-term Debt	41,229	194.6%	100,000	141,229	116.5%
Short-term Debt	<u>0</u>	<u>0.0%</u>	<u>0</u>	<u>0</u>	<u>0.0%</u>
Sub-Total	41,229	194.6%	100,000	141,229	116.5%
Total Capitalization	<u>21,190</u>	<u>100.0%</u>	<u>100,000</u>	<u>125,588</u>	<u>100.0%</u>

Capital structures are normally subject to review in cost of capital or general rate case proceedings. We will not, therefore, make a finding in this decision of the reasonableness of the projected capital ratios for ratemaking purposes.

In Resolution (Res.) ALJ 176-3134 dated May 27, 2004, the Commission preliminarily categorized this Application as ratesetting, and preliminarily determined that hearings were not necessary. No protests have been received. Given these developments, a public hearing is not necessary, and there is no need to alter the preliminary determinations made in Res. ALJ 176-3134.

Comments on Draft Decision

This is an uncontested matter in which the decision grants the relief requested. Accordingly, pursuant to Pub. Util. Code 311(g)(2), the otherwise applicable 30-day period for public review and comment is being waived.

Assignment of Proceeding

Izetta C.R. Jackson is the assigned Examiner in this proceeding.

Findings of Fact

1. DOWC, a California corporation, is a water utility subject to the jurisdiction of this Commission.

2. DHS has determined that DOWC violated the provisions contained in H&S Code and Title 22 of the CCR.

3. If DOWC fails to perform any of the tasks specified in DHS' Compliance Order No. 03-19-040-001, the utility will be subjected to additional judicial action, including civil penalties.

4. DOWC needs external funds for the purposes set forth in the Application.

5. The money, property, or labor to be procured or paid for by the proposed debt issue is reasonably required for the purposes specified in the Application.

6. Authorizing DOWC to secure a loan with interest rate based on existing market conditions at the time of negotiating the terms, as set forth in the Application would not be adverse to the public interest.

7. The reasonableness of any resulting interest rate and cost of money arising from debt capital is normally subject to review in cost of capital or general rate case proceedings.

8. The ratebase recovery of the costs associated with the financing requested in this Application will be addressed in DOWC's Country Estates District GRC.

9. The Commission does not by this decision determine that DOWC's construction budget, cash requirements forecast, and capital

ratios presented herein are necessary or reasonable for ratemaking purposes. These issues are normally tested in general rate case or cost of capital proceedings.

10. Notice of the filing of the Application appeared on the Commission's Daily Calendar of May 12, 2004. There is no known opposition to this Application, and the authority requested should be granted.

Conclusions of Law

1. A public hearing is not necessary.
2. The Application should be granted to the extent set forth in the order that follows.
3. The rate base recovery requested in the Application should be denied without prejudice.
4. Recovery of plant or improvements associated with debt capital should be by separate advice letter filing, subject to reasonableness review, when the improvements are completed.
5. This authorization is not a finding of the value of DOWC's stock or property, nor does it indicate approval of matters subject to review in ratemaking proceedings.
6. DOWC should pay the fee for the authority granted in this order as determined in accordance with Pub. Util. Code § 1904(b).
7. The following order should be effective on the date of signature.

ORDER

IT IS ORDERED that:

1. Del Oro Water Company Inc. (DOWC), on or after the effective date of this order is authorized:
 - a) Within the next one hundred twenty days, to borrow up to \$100,000, at prevailing rates; and
 - b) To execute and deliver any and all related documents required for the completion of the loan.
2. DOWC shall apply the proceeds of the loan authorized for capital improvements within its Country Estates District as specified in Application 04-05-015 and discussed in this Decision.
3. DOWC shall file with the Audit and Compliance Branch of the Water Division, copies of the loan documents within thirty days of the execution of these documents.
4. DOWC's request in the Application to recover the improvement costs thru a rate base offset is denied without prejudice.
5. The authority granted in Ordering Paragraph 1 is contingent upon DOWC obtaining written approval from the California Department of Health Services that the project to be undertaken with the loan proceeds will place DOWC's Country Estates District in compliance with the DHS Surface Water Treatment Regulations.
6. The authority granted by this order shall become effective when DOWC pays \$200, the fee set forth by Public Utilities Code § 1904(b).

7. Application 04-05-015 is closed.

This order is effective today.

Dated August 19, 2004, at San Francisco, California.

MICHAEL R. PEEVEY

President

CARL W. WOOD

LORETTA M. LYNCH

GEOFFREY F. BROWN

SUSAN P. KENNEDY

Commissioners